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No. 238

In the Supreme Court of the United States

OCTOBER TERM, 1935

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

E. E. COMBS AND EDWARD EVERETT, TRUSTEES OF E. E. COMBS WELL NO. 2, EXPRESS TRUST

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE PETITIONER

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v.

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OPINIONS BELOW

The memorandum opinion of the Board of Tax Appeals (R. 20–26) is unreported. The opinion of the Circuit Court of Appeals (R. 50) is reported in 76 F. (2d) 682.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered April 11, 1935 (R. 53). A petition for a writ of certiorari was filed July 11, 1935, and

was granted October 14, 1935. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the trust here involved was an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

STATUTE AND REGULATIONS INVOLVED

Revenue Act of 1926, c. 27, 44 Stat. 9:

> SEC. 2. (a) When used in this Act—
>
> * * * * *
>
> (2) The term "corporation" includes associations, joint-stock companies, and insurance companies.
>
> * * * * *
>
> [U. S. C., Title 26, Sec. 1696.]

Treasury Regulations 69:

> ART. 1502. *Association.*—Associations and joint-stock companies include associations, common-law trusts, and organizations by whatever name known, which act or do business in an organized capacity, whether created under and pursuant to State laws, agreements, declarations of trust, or otherwise, the net income of which, if any, is distributed or distributable among the shareholders on the basis of the capital stock which each holds, or, where there is no capital stock, on the basis of the proportionate share or capital which each has or has in-

vested in the business or property of the organization. A corporation which has ceased to exist in contemplation of law but continues its business in quasi-corporate form is an association or corporation within the meaning of section 2.

ART. 1504. *Association distinguished from trust.*—Where trustees merely hold property for the collection of the income and its distribution among the beneficiaries of the trust, and are not engaged, either by themselves or in connection with the beneficiaries in the carrying on of any business, and the beneficiaries have no control over the trust, although their consent may be required for the filling of a vacancy among the trustees or for a modification of the terms of the trust, no association exists, and the trust and the beneficiaries thereof will be subject to tax as provided by section 219 and by articles 341–347. If, however, the beneficiaries have positive control over the trust, whether through the right periodically to elect trustees or otherwise, an association exists within the meaning of section 2. Even in the absence of any control by the beneficiaries, where the trustees are not restricted to the mere collection of funds and their payment to the beneficiaries, but are associated together with similar or greater powers than the directors in a corporation for the purpose of carrying on some business enterprise, the trust is an association within the meaning of the statute.

STATEMENT

The facts as stipulated and as found by the Board of Tax Appeals may be summarized as follows:

Under date of February 6, 1925, the Hub Oil Company, as a holder of an oil and gas lease in California, and E. E. Combs and Edward Everett, as trustees, signed a "Memorandum of Formation of Express Trust" for the purpose of financing and drilling a well for the production and sale of oil and other hydrocarbon substances. (R. 36.)

The Hub Oil Company assigned all of its rights under the lease subject to a reservation to it of 6.5% of all oil, gas and other hydrocarbons produced and to a reserved royalty of 2% to one Henry D. Smithson. (R. 37.)

The Hub Oil Company (hereinafter called the assignor) agreed to supply certain drilling equipment for which it should be reimbursed out of the first proceeds from the sale of oil, with the proviso that the assignor might repossess the equipment in the event of the abandonment or suspension of active drilling operations for more than sixty days. (R. 37.)

The agreement stated that one Sheridan Bailes, an oil well driller, had already contracted with Combs and Everett to furnish other equipment and superintend drilling and producing operations in consideration of the receipt of a 12% royalty. The trust estate was to pay all proper labor claims incurred in drilling operations and for all drilling

and production materials not supplied by the assignor or Sheridan Bailes. (R. 37–38.)

The "whole beneficial interest" in the trust was to be 71⅓% of the gross production of the well. This interest was to be owned as follows: (1) 25% less certain deductions for trust obligations to beneficiaries who should provide money for trust purposes, (2) 44⅓% less like deductions to E. E. Combs and (3) 2% to Edward Everett, also less such deductions. (R. 40–41.)

The agreement provided for the issuance of certificates of beneficial interest transferable only upon the books of the trust when endorsed and surrendered. (R. 41, 42–43.) A list of the subscriptions appears in the record (p. 42).

The beneficial interests of Combs could also be sold by the trustees for the purpose of raising funds to pay the expenses which were not met by the funds of the beneficiaries. (R. 39.)

The trustees were given the power to hold all property, the legal title to which might vest in them under the trust; to use moneys deposited by beneficiaries to pay for labor and materials incident to drilling and producing; to exercise all rights of a lessee under the lease except as otherwise provided; to pay the trust debts, manage the trust property, borrow money, sell the products of the well and sell any remaining beneficial interest. They were not to be liable for any act except wilful misconduct. (R. 38–39.)

Combs was also to act as production manager when the well started producing. (R. 39.)

All proceeds of the sale of well products were to be paid direct to the Bank of Italy (or some other bank designated by the trustees) to be distributed among the beneficiaries, after the bank had paid claims for labor and materials which had been approved by the trustees. (R. 40.)

The provisions of the trust were carried out, a well was drilled in 1925 and produced oil through 1925 and for a portion of the year 1926 until the lease was sold and the trust terminated. (R. 35.)

The assignor furnished the required equipment and received $15,000 therefor out of the first oil produced and sold. Bailes received 12% of the gross production and the thirteen beneficiaries who contributed $25,000 to the trust received 25% of the net production. Combs sold 9¼% of the interest assigned to him for $9,250, which was expended on drilling costs. He transferred 4.69% of the net production to drillers and to an agent as a commission for obtaining the lease. (R. 35.)

The beneficiaries never held a meeting. The trust had no office or place of business, no name, seal, or by-laws. The trustees acquired only the one lease and did not borrow money or engage in any other business. (R. 35–36.)

The Commissioner classified the trust as an association for the years 1925 and 1926 and determined deficiencies of $2,741.95 and $4,627.27. (R. 10.)

The Board of Tax Appeals reversed the Commissioner's determination and the Circuit Court of Appeals sustained the Board.

ARGUMENT

The sole question in this case is whether the trust involved is an association within the meaning of Section 2 (a) (2) of the Revenue Act of 1926.

The same general question is involved in *T. A. Morrissey and James M. O'Brien, Trustees of an express trust known as the Western Avenue Golf Club* v. *Helvering*, No. 17, October term, 1935, in *Helvering* v. *Coleman-Gilbert Associates*, Nos. 78 and 79, October term, 1935, and in *Joseph E. Swanson, etc.* v. *Helvering*, No. 108, October term, 1935.

We think that no useful purpose will be served by repeating herein the arguments made in the Government's briefs in the first two of those cases, which we incorporate herein by reference.

Our position is that a trust which is doing business is an association within the meaning of the statute, regardless of whether it employes a seal, by-laws, formal meetings of the trustees analogous to directors' meetings and other devices of a corporation.

The trustees in this case did not argue before the court below that they were not doing business. The court below said (R. 52):

> As we understand the respondents they do not question that the trust herein was doing business, but they contend that they do not

meet the second test. They claim that they "were neither organized nor did they operate in any sense of the word along the modes, methods and manners ordinarily employed by corporations."

We understand, therefore, that the trustees have conceded that the trust was doing business.

The same court that decided this case has held in other cases that the doing of business is sufficient to characterize a trust as an association. *Trust No. 5833, Security-First Nat. Bank* v. *Welch*, 54 F. (2d) 323, certiorari denied, 286 U. S. 544; *Sloan* v. *Commissioner*, 63 F. (2d) 666; *Twin Bell Oil Syndicate* v. *Helvering*, 70 F. (2d) 402, reversed on other grounds, 293 U. S. 312. For reasons stated in the briefs in the *Morrissey* case and the *Coleman-Gilbert Associates* case, we think that the earlier opinions of that court express the better view.

If more is required, however, we think that the trust here involved resembled a corporation in matters of substance. It had certificates of beneficial interest which could be transferred without affecting the continuity of the trust. The trustees had no personal liability for obligations of the trust, and there is nothing to indicate that creditors could look to anything other than the trust funds for payment of their obligations. The business of the trust was conducted by the trustees for the beneficiaries. Hence, there were continuity, centralized control, and limited lia-

bility which are the distinguishing features of a corporation under the decision of this Court in *Flint* v. *Stone Tracy Co.*, 220 U. S. 107.

We submit that the trust should be treated as an association.

CONCLUSION

The judgment of the Circuit Court of Appeals should be reversed.

Respectfully submitted.

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